

## Internal Revenue Service

Number: **200821007**

Release Date: 5/23/2008

Index Number: 1295.02-02

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

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CC:INTL:B02

PLR-114945-07

Date:

February 19, 2008

TY:

### Legend

Taxpayer =

FC1 =

FC2 =

FC3 =

FC4 =

Country W =

Country X =

Country Y =

Country Z =

A =

B =

C =

D =

E =

F =

G =

Year 1 =

Year 2 =

Year 3 =

Accounting Firm 1 =

Accounting Firm 2 =

Accountant 1        =  
Accountant 2        =

Dear                :

This is in response to your letter dated March 23, 2007, submitted by your authorized representative, requesting the consent of the Commissioner to make a retroactive qualified electing fund ("QEF") election under Treas. Reg. §1.1295-3(f) with respect to FC1's investments in FC2 and FC3.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

#### FACTS

FC1, a Country W company, is wholly owned by Taxpayer. Its principal activities consist of investment holding and provision of business consultancy services. FC1 owns A percent of FC2, a Country X corporation. Another A percent of FC2 is owned by FC4, a Country Y corporation, which is wholly owned by a Country Z national. The remaining B percent of FC2 is owned by a non-U.S. person unrelated to Taxpayer.

FC1, FC2, and FC4 also own, respectively, C, D, and E percent of FC3, a Country W corporation. FC3 is a holding company that wholly owns various subsidiaries engaged in the F industry. Each subsidiary owns and operates a G.

Due to recent economic conditions and increases in the price of Gs, Taxpayer and his Country Z partner decided in Year 1 to dispose of the Gs owned by the various subsidiaries. The Gs were sold in Year 1, Year 2, and Year 3. After each sale of a G, the subsidiary that owned it remained active for at least six months to a year to cover any outstanding liabilities and costs, and was then liquidated. Those subsidiaries that were wholly owned were liquidated pursuant to IRC section 332. The proceeds of the sales and excess cash were distributed to FC3.

Accountant 1 with Accounting Firm 1 advised Taxpayer on his U.S. income tax matters and prepared all of his U.S. federal income tax returns in Year 1 and Year 2. Accountant 1 represents that Taxpayer provided him with access to Taxpayer's financial records in order to prepare accurate and complete U.S. income tax returns. Accountant 1 also represents that he is a tax professional in Country Y and has many years of international tax compliance experience and is competent to render U.S. tax advice with respect to stock ownership of a foreign corporation.

In Year 3, Taxpayer hired Accountant 2 with Accounting Firm 2 to advise him and prepare all of his U.S. federal income tax returns. Accountant 2 reviewed the financial statements for FC2 and FC3 and determined that they were passive foreign investment companies ("PFICs") within in the meaning of IRC section 1297 since Year 2.

Taxpayer has submitted an affidavit, under penalties of perjury, describing the events that led to the failure to make the QEF election by the election due date, including the role of Accountant 1. Taxpayer represents that for all tax issues related to the ownership of FC2 and FC3 in Year 2, Taxpayer relied on the advice of Accountant 1. Taxpayer has also submitted an affidavit of Accountant 1 corroborating the statements made by Taxpayer.

Taxpayer represents that as of the date of this ruling request, the PFIC status of FC2 and FC3 has not been raised by the IRS on audit for any of the taxable years.

#### RULING REQUESTED

Taxpayer requests the consent of the Commissioner of the Internal Revenue Service to make a retroactive QEF election under Treas. Reg. § 1.1295-3(f) with respect to FC1's investments in FC2 and FC3 for his Year 2 taxable year.

#### LAW AND ANALYSIS

Section 1295(a) provides that any PFIC shall be treated as a QEF with respect to a taxpayer if (1) an election by the taxpayer under section 1295(b) applies to such company for the taxable year and (2) the company complies with such requirements as the Secretary may prescribe for purposes of determining the ordinary earnings and net capital gains of such company.

Under section 1295(b)(2), a QEF election may be made for any taxable year at any time on or before the due date (determined with regard to extensions) for filing the return for such taxable year. To the extent provided in regulations, such an election may be made after such due date if the taxpayer failed to make an election by the due date because the taxpayer reasonably believed the company was not a PFIC.

Under Treas. Reg. § 1.1295-3(f), a taxpayer may request the consent of the Commissioner to make a retroactive QEF election for a taxable year. However, the Commissioner will grant relief under Treas. Reg. § 1.1295-3(f) only if four conditions are satisfied. The first requirement is that the shareholder reasonably relied on a qualified tax professional, who failed to identify the foreign corporation as a PFIC or failed to advise the shareholder of the consequences of making, or failing to make, a section 1295 election. Treas. Reg. § 1.1295-3(f)(2) provides that a shareholder will not be considered to have reasonably relied on a qualified tax professional if the shareholder

knew, or reasonably should have known, that the foreign corporation was a PFIC and knew of the availability of a section 1295 election. In addition, a shareholder cannot claim reliance upon a qualified tax professional if he knew or reasonably should have known that the tax professional relied upon was not competent to render tax advice with respect to the ownership of shares of a foreign corporation or did not have access to all relevant facts and circumstances.

According to the facts submitted and the representations made, Taxpayer relied on the advice of Accountant 1, who failed to identify FC2 and FC3 as PFICs, and failed to advise him of the consequences of making, or failing to make, QEF elections. Accountant 1 was competent to render tax advice with respect to the ownership of shares of a foreign corporation and had access to all relevant facts and circumstances. Additionally, Taxpayer did not know, and should not reasonably be expected to have known, that FC2 and FC3 were PFICs, or of the availability of a QEF election. Thus, Taxpayer reasonably relied on a qualified tax professional within the meaning of Treas. Reg. § 1.1295-3(f)(1)(i) and (2) for Year 2.

The second requirement of Treas. Reg. § 1.1295-3(f) is that granting consent will not prejudice the interests of the U.S. government. Under Treas. Reg. § 1.1295-3(f)(3)(i), the interests of the U.S. government are prejudiced if granting relief would result in the shareholder having a lower tax liability, taking into account applicable interest charges, in the aggregate for all years affected by the retroactive election (other than by a de minimis amount) than the shareholder would have had if the shareholder had made the section 1295 election by the election due date. The time value of money is taken into account for purposes of this computation. If granting relief would prejudice the interests of the U.S. government, the Commissioner may, in his sole discretion, grant consent to make the election provided the shareholder enters into a closing agreement with the Commissioner that requires the shareholder to pay an amount sufficient to eliminate any prejudice to the U.S. government as a consequence of the shareholder's inability to file amended returns for closed taxable years. Treas. Reg. § 1.1295-3(f)(3)(ii).

In the present case, neither the Year 2 taxable year nor subsequent tax years currently are closed. Thus, the interests of the U.S. government will not be prejudiced by allowing Taxpayer to make a retroactive section 1295 election.

The third requirement of Treas. Reg. § 1.1295-3(f) is that the request must be made before a representative of the Internal Revenue Service raises upon audit the PFIC status of the corporation for any taxable year of the shareholder. Treas. Reg. § 1.1295-3(f)(1)(iii). In this case, the PFIC status of FC2 and FC3 has not been raised upon audit.

The final requirement of Treas. Reg. § 1.1295-3(f) is that the procedural requirements set forth in Treas. Reg. § 1.1295-3(f)(4) must be met. These include filing

a request for consent to make a retroactive election with, and submitting a user fee to, the Office of the Associate Chief Counsel (International). Treas. Reg. § 1.1295-3(f)(4)(i). Additionally, affidavits signed under penalties of perjury must be submitted by the shareholder and any qualified tax professional upon whose advice the shareholder relied. Treas. Reg. § 1.1295-3(f)(4)(ii), (iii). These affidavits must describe the events that led to the failure to make a QEF election by the election due date, the discovery of such failure, and the engagement and responsibilities of the qualified tax professional and the extent to which the shareholder relied on such professional. Here, affidavits meeting the requirements set forth in Treas. Reg. § 1.1295-3(f)(4)(ii) and (iii) as to Accountant 1's failure to inform Taxpayer of his need to make the QEF election has been submitted and Taxpayer has otherwise satisfied the procedural requirements of Treas. Reg. § 1.1295-3(f)(4).

Based on the information submitted and representations made, consent is granted to Taxpayer to make a retroactive election with respect to Year 2, under Treas. Reg. § 1.1295-3(f), provided that Taxpayer complies with the rules under Treas. Reg. § 1.1295-3(g) regarding the time and manner for making the retroactive QEF election.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this ruling must be attached to any tax return to which it is relevant.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to Taxpayer's authorized representative.

Sincerely,

Ethan A. Atticks  
Senior Technical Reviewer, CC:INTL:B02  
Office of Associate Chief Counsel  
(International)

cc: